

- c. Documentation regarding the change of ownership must be filed with the Division of Licensing and Regulation, Office of Inspector General, with the Department for Medicaid Services, and with either the Interim Office of Health Planning and Certification or the Health Policy Board, as applicable, to ensure the basis of the sale. The increase in valuation of capital assets shall be allowed only if the Department concludes, based on documentation presented, that a bona fide arms length commercial transaction, meeting applicable state and federal laws and regulations, has occurred. The increase in valuation shall not be allowed if the change of ownership is between related parties.

- d. The increase in valuation shall be based on data in the cost report (annualized as necessary) if available; if a change of ownership has occurred but is not reflected in the cost report used to set the facility rate, the facility may submit a rate adjustment request using Schedule J. If a Schedule J rate adjustment is requested and approved the rate adjustment shall be made for the month in which the change of ownership has occurred (but shall not affect payment rates for a month preceding July 1995).
- e. The new useful life of the facility established by the Department at the time the increase in valuation of the asset due to a change of ownership is recognized shall begin, for historical cost purposes, at the effective date of the change of ownership.

- f. This change shall be applicable for facility rates made for periods beginning July 1, 1995 and thereafter. No rate adjustment shall be applicable for services provided prior to July 1, 1995, or for periods preceding the finalization of the transfer or ownership.

C. SPECIAL CIRCUMSTANCES. For the following circumstances the basis of an asset shall be determined in accordance with the specific provisions of Health Insurance Manual 15 which pertains to these circumstances.

1. Intergovernmental transfers of assets.
2. Donated Assets.
3. Assets partially or fully depreciated prior to entry into the program.

351. DEPRECIATION EXPENSE

A. PRINCIPLE. An appropriate allowance for depreciation expense on buildings and equipment shall be an allowable expense. The depreciation shall be:

1. Identifiable and in the facility's accounting records;
2. Based on the allowable basis as determined under Section 350; and
3. Prorated over the useful life of the asset.

B. METHOD OF DEPRECIATION

1. Assets shall be depreciated using the straight-line method, unless another method has been authorized for the facility by Title XVIII; in which case, the facility may elect to utilize the method authorized for Title XVIII purposes.

C. USEFUL LIVES

1. In selecting a proper useful life, the 1988 Edition of the American Hospital Association's "Estimated Useful Lives of Depreciable Hospital Assets" shall be used with respect to assets acquired in 1989 or later years. For assets acquired from 1983 through 1988, the 1983 Edition of the AHA's guidelines shall be used. For assets acquired in 1982, the 1978 Edition of the AHA's guidelines shall be used. For assets acquired before 1982, the 1973 Edition of the AHA's "Chart of Accounts for Hospitals" shall be used; or for assets acquired before 1981, guidelines published by the Internal Revenue Service, with the exception of those offered by the Asset Depreciation Range System, shall be used.

352. INTEREST EXPENSE

A. PRINCIPAL. Unless otherwise stated in this manual, interest expense shall be an allowable cost if it meets Title XVIII Principles and it is both necessary and proper in accordance with the provisions of this manual.

B. DEFINITIONS.

1. Interest. Interest is the cost incurred for the use of borrowed funds.

2. Necessary. Necessary requires that the interest:

a. Be incurred on a loan made to satisfy a financial need of the provider which is related to patient care. Loans which result in excess funds or investments shall not be considered necessary.

b. Be incurred on a loan made for the following purposes:

(1) Represent interest on long-term debt existing at the time the provider enters the Program plus interest on any new

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long-term debt, the proceeds of which are used to purchase fixed assets relating to the provision of the appropriate level of care not to exceed the allowable basis of the assets. If the debt is subject to variable interest rates found in "balloon" type financing, renegotiated interest rates subject to tests of reasonableness shall be allowable. The form of indebtedness may include mortgages, bonds, notes, and debentures when the principal is to be repaid over a period in excess of one year.

- (2) Other interest for working capital and operating needs that directly relate to providing patient care is an allowable cost. Working capital interest shall be limited to the interest expense which would have been incurred on two months of Medicaid Receivables. The amount on which this limitation is to be based is computed for cost reporting purposes by determining the monthly average Medicaid payments (both routine and ancillary) for the Cost Reporting period and multiplying

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the amount by two. Once the allowable amount of borrowing has been determined, it is multiplied by the provider's average working capital borrowing rate in order to determine the maximum allowable working capital interest.

It should be emphasized that the two month limit is a maximum. Working capital interest shall not be allowable simply because it does not exceed the two month limitation. Working capital interest that meets the two month test shall meet all other tests of necessary and proper in order for it to be considered allowable.

- (3) Be reduced by investment income except where such income is from gifts and grants, whether restricted or unrestricted, and which are held separate and not commingled with other funds, or have been separated, if necessary. When investment income is derived from combined or pooled funds, only that portion of

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investment income resulting from the facility's assets after segregation shall be considered in the reduction of interest cost. Income from funded depreciation, a provider's qualified pension fund, or a formal deferred compensation plan shall not be used to reduce interest expense so long as these funds are used only for those purposes for which they were created.

3. Proper. Proper requires that interest:

- a. Be incurred at a rate not in excess of what a prudent borrower would have had to pay in the money market existing at the time the loan was made.
- b. Be paid to a lender not related through control or ownership, or personal relationship to the borrowing organization. However, interest is allowable if paid on loans that meet one of the related party exemptions of 352 C 2.

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C. BORROWER-LENDER RELATIONSHIP.

1. To be allowable, interest expense shall be incurred on indebtedness established with lenders or lending organizations not related through control, ownership, or personal relationship to the borrower. Presence of any of these factors could affect the "bargaining" process that usually accompanies the making of a loan, and could thus be suggestive of an agreement on higher rates of interest or of unnecessary loans. Loans shall be made under terms and conditions that a prudent borrower would make in arms-length transactions with lending institutions. Thus, interest paid by the facility to partners, stockholder, or related organizations of the facility shall not be allowable.